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S E C R E T SECTION 01 OF 03 VILNIUS 001007

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STATE FOR EUR/NB, L, EB/CBA
COMMERCE FOR ITA/ADVOCACY CENTER

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SUBJECT: ADAMKUS UPSET ABOUT CONOCOPHILLIPS-LUKOIL BID ON
THE BALTIKS' ONLY OIL REFINERY

REF: A. VILNIUS 781
 B. VILNIUS 380
 C. VILNIUS 326

Classified By: Economic Officer Scott Woodard for reasons 1.4 (b) and (d)

¶11. (S) SUMMARY: ConocoPhillips (CP) and Lukoil's plan to submit a joint bid to buy a controlling share of Mazeikiu Nafta (MN) has met with strong expressions of concern from some elements of the GOL, including President Adamkus. Representatives of the two firms visited Vilnius September 19 to pitch their interest in MN, the only oil refinery in the Baltics and Lithuania's largest economic asset, which the Russian company Yukos currently owns. If CP, in partnership with Lukoil, asks us to advocate on behalf of its bid, we will have a dilemma. While the promise of Lukoil's ability to assure a supply of Russian crude oil is seductive to many here, others (including Adamkus) see Lukoil as beholden to the Kremlin and guilty of a long history of dirty tricks in Lithuanian domestic politics. That belief, coupled with many Lithuanians' perception that the former (American) owner of the refinery underhandedly transferred ownership of MN to the Russians in 2002, makes this situation particularly sensitive for us. In addition, a high-level MFA official told the Ambassador that Lukoil has established a USD 15 million slush fund to smear and/or blackmail President Adamkus, whom the company (correctly) believes is a strong opponent of MN's sale to Lukoil. If we vigorously assist a CP-Lukoil consortium in purchasing MN, even many of our friends here will accuse us of naively serving Russian interests. END
SUMMARY.

MAZEIKIU NAFTA: LITHUANIA'S BIGGEST ECONOMIC ASSET

¶12. (U) Mazeikiu Nafta (MN) is the only oil refinery complex in the Baltics. MN is Lithuania's biggest industrial facility and, according to some estimates, generates as much as 10 percent of the country's GDP. It produced revenue in 2004 of approximately LTL 7.7 billion (USD 2.7 billion), more than double the revenues of Lithuania's next largest company. Its pre-tax profits last year were more than LTL 900 million (USD 310 million). Yukos is the majority shareholder of MN, holding 53.7 percent of shares through a company registered in the Netherlands. The GOL is the other major shareholder, with a 40.6 percent stake. The remaining 5.7 percent of shares trade actively on the Vilnius bourse.

¶13. (U) We reported earlier (refs A and B) that Yukos wants to sell its stake in MN. According to the legal agreements governing MN, however, the GOL must approve the sale.

A PLETHORA OF POTENTIAL BUYERS, INCLUDING U.S. COMPANIES

¶14. (C) High-level executives from several of the world's major oil companies, including TNK-BP, Gazprom, KazMunayGaz, PKN Orlen, Lukoil, and ConocoPhillips have visited Lithuania since April. TNK-BP's Vice President for International Affairs Shawn McCormick told us in May that his company was interested in MN and that he was briefing both the British and U.S. Embassies on the progress of TNK-BP's talks with the GOL. (He cited BP's presence in the United States to explain why he was keeping us in the loop.)

¶15. (C) ConocoPhillips's President of International Downstream Operations, Mike Fretwell, and Lukoil's Director of Strategic Development, Andrei Gaidamaka, told us on September 19 that their companies were seriously considering a joint bid for MN. They explained that their firms had not yet decided on the two firms' relative participation in the bid, but did not rule out the creation of a new company, held 50-50 between the two, that would serve as the bidding entity. CP-Lukoil's representatives contacted us on September 14 asking us to help set up meetings with GOL officials for September 19. We did so. The company has not explicitly asked for any additional advocacy on its behalf. However, in his meeting with the Ambassador September 19, Fretwell clearly hoped for further assistance from us in emphasizing the "American"

provenance of the bid.

16. (C) Fretwell and Gaidamaka told us at the end of their day in Vilnius that meetings with the Minister of Economy, an adviser to the Prime Minister, and three parliamentary leaders did little to clarify the situation regarding the sale of MN's shares. Fretwell and Gaidamaka said that their GOL interlocutors explained that the GOL might be willing to sell some of its holdings in MN to complement the shares Yukos would sell. However, Fretwell and Gaidamaka said that they were unable to pin down exactly how many of its shares the GOL might be willing to divest, when, or at what price. This, said the executives, made it difficult for their companies to figure out how to proceed.

NOT EVERYBODY LOVES LUKOIL

17. (C) Lukoil's ability to secure a steady supply of crude oil for MN is seductive to many here, especially the Social Democrats (successors to the Lithuanian Communist Party), who head the governing coalition. Critics, especially members of the conservative opposition, allege that Social Democrat Prime Minister Algirdas Brazauskas has received kickbacks from this Russian company, which they see as a wholly owned subsidiary of the Kremlin.

18. (C) Other critics of Lukoil include people close to President Adamkus. We understand that Adamkus himself strongly shares this view. In their view, Lukoil's ownership of MN, because of what they consider to be an inexorable tie to the Kremlin, could lead to a loss of sovereignty over critical decisions affecting one of Lithuania's most valuable assets and to increased vulnerability to Russia's use of oil as an instrument of influence over Lithuania. Even more troubling to many is Lukoil's alleged history of manipulating internal Lithuanian politics to advance its commercial interests. Foreign Minister Valionis told the Ambassador on September 22 that he has it on good authority that Lukoil was a major contributor to campaign funds for former President Rolandas Pakšas, whom the Parliament impeached in April 2004 for, among other things, having too close ties to Russian interests.

LUKOIL PREPARED TO PLAY DIRTY?

19. (S) The Director of the MFA's Americas Department, Jonas Paslauskas, told the Ambassador on September 21 that his ministry had information that Lukoil was not going to let MN "slip through its fingers again." (NOTE: Lukoil has long had a strategic aim to acquire the refinery. It lost out to Williams in the 90's and was a potential buyer again when Williams sold the refinery to Yukos in 2002. END NOTE.) He said that Lukoil considers President Adamkus to be its biggest obstacle to buying MN. He indicated that the GOL has intelligence that the company has budgeted USD 15 million for a smear campaign designed to discredit Lithuania's president. The campaign, he said, will allege that during a trip to the USSR that Adamkus took as a U.S. EPA official, Adamkus slipped away from his planned itinerary to meet a KGB handler. Paslauskas said that intelligence sources indicate that Lukoil is already constructing an incriminating story about Adamkus by sending employees to the former Soviet cities Adamkus visited while working as an EPA official. (NOTE: Adamkus, who was born in Lithuania but emigrated to the United States and then returned to Lithuania in the late 1990s, began visiting Soviet Union in 1972 and made annual trips there, bringing emigre literature to and organizing study visits in the Lithuanian SSR. He retired from the EPA in 1997, and became President of Lithuania in 1998. END NOTE.) Alternatively, Paslauskas said that Lukoil might simply use the allegations to blackmail Adamkus, seeking to force him to avoid opposing Lukoil's bid for MN.

COMMENT: A SERIOUS DILEMMA

110. (C) Our insertion into this process on CP's -- and, by extension, Lukoil's -- behalf will expose the USG on an issue that is already uniquely neuralgic for us here because of the circumstances surrounding the sale of MN by the U.S. firm Williams to Yukos. That story has only started to fade from the collective memory in the last year. Rightly or wrongly, many Lithuanians blame us for delivering Lithuania's single largest economic asset to the Russians in the first place. If we advocate aggressively on CP-Lukoil's behalf, many of those same people (many of whom are our friends) would say that we are naively serving Russian interests here again, allowing them to use CP as a figleaf for their objectives here.

111. (C) Given the risks, we believe that this is one of those

rare cases in which the Embassy should not assume an advocacy role on an American firm's behalf. We will be happy to meet with CP and its partner as the bid process proceeds. However, given our broader interests here, we would prefer to forego a direct role in the competition for MN, especially if CP-Lukoil remains the only "American" contestant.

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